

Project Name Korea-Financial Intermediation Project (FIP)

Region East Asia & Pacific

Sector Financial System Development

Project ID KRPA4172

Implementing Agency Ministry of Finance
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Objectives

1. The main objectives of the loan are to:
 - (a) support the Government of Korea (GOK) in its program for accelerating deregulation of the financial system;
 - (b) support the institution building programs of three participating financial institutions (PFIs): the Industrial Bank of Korea (IBK), the Citizens National Bank (CNB), and the Korea Technology Banking Corporation (KTBC);
 - (c) provide long-term credits to eligible private manufacturing enterprises, mainly small and medium enterprises, through the PFIs; and
 - (d) improve the technical capabilities of the professionals in the financial sector and government organizations responsible for financial sector policies through training and technical assistance programs to be managed by the Korea Banking Institute (KBI).

Description

2. The vehicle that will be used by the Bank to address financial sector policies in Korea is the proposed FIP. The Bank loan will consist of a credit component of about US\$94 million equivalent through the PFIs for private sector lending and a training and technical assistance component of US\$6 million equivalent. A US dollar single currency loan will be made to the GOK which will relend to the three PFIs in US dollars at the standard IBRD variable rate (LIBOR-based) plus an administrative fee of 0.05% (5 basis points). The PFIs would relend the funds in US dollars to sub-borrowers with prospective earnings in foreign exchange at the prevailing six-month US dollar LIBOR rate plus a spread to be determined by each PFI. The PFIs' subsidiary loans would have maturities corresponding to the maturities of their subloans. Each PFI is managed autonomously, is financially sound, and manages the risk

associated with the foreign currency compositions of their assets and liabilities. Each investment project will be subject to a minimum internal rate of return of 15%. Each investment project will also have to be in full compliance with the environmental regulations prevailing in Korea.

The proposed technical assistance component of the project would support Korea in developing skills that would be needed to meet the structural changes in the financial sector that are envisaged under the country's economic plan. The technical assistance component would aim at:

- (a) providing a training program for Korean bankers designed to meet the challenges of a liberalized and internationalized financial sector;
- (b) increasing the quality of KBI's in-house training service and facilities by improving instructional materials and curriculum design, upgrading of administrative and teaching staff, and improving the evaluation of training schemes; and
- (c) providing overseas training and short-term professional courses abroad to about 48 officials of the Ministry of Finance and other economic ministries, and short-term professional courses suitable for higher level government staff.

Environmental Aspects

4. Environmental assessment Category B. Since the proposed project is a financial intermediary loan, it will involve financing small and medium enterprises. Some of the proposed subprojects may adversely affect the environment unless appropriate safeguards are built in. The impact on the environment will depend on the type of investment projects to be financed under the proposed loan. The PFI will be required to ensure that each investment project financed under the proposed loan is in full compliance with the environmental regulations in Korea. Loan agreements between the PFIs and sub-borrowers will stipulate that sub-borrowers must comply with the prevailing regulations in Korea. The PFIs will require the sub-borrower to carry out an environmental assessment with the assistance of consultants for investment in projects or areas which are considered environmentally sensitive by the Korean authorities. The PFIs will also appoint a loan officer as a resource person on the environmental aspects. An understanding was reached that KBI will offer courses (3-5 days) on the environment for loan officers of financial institutions in 1994.

Implementation

5. The project would be implemented by the Ministry of Finance, the PFIs, and KBI.

6. The PFIs will be subject to operational and financial criteria. Eligibility criteria for CNB and IBK will include:

- (a) capital adequacy requirement;
- (b) approval of a corporate strategy statement;
- (c) presentation of a two year training program in project finance; and
- (d) an audit by independent external auditors in accordance with generally accepted accounting principles.

Eligibility criteria for KTBC will include:

- (a) a timetable for privatization;
- (b) approval by the Bank of its business plan and corporate strategy;
- (c) an audit by an independent external auditor in accordance with generally accepted accounting principles; and
- (d) a maximum debt/equity ratio of 6:1 and a minimum debt service coverage ratio of 1.5.

Cost and Financing

7. Project costs are estimated at US\$0 million, of which the Bank would finance US\$100 million. The credit component would constitute US\$241 million, of which \$94 million would be financed by the Bank. The technical assistance component amount to US\$9 million, of which \$6 million would be financed by the Bank.

8. For goods, works and services financed by the participating financial institutions (CNB, IBK and KTBC), the Bank would disburse 100% against eligible foreign expenditures, and 70% against local expenditures. For technical assistance, the Bank would disburse 100% against eligible foreign expenditures, and 90% against local expenditures.

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Note: This is information on an evolving project. Certain components may not necessarily be included in the final project.